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SUBJECT: MADRID WEEKLY ECONOMIC UPDATE -- SEPT 2-5

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Unemployment Continues to Rise

¶1. (U) The number of unemployed increased by 103,085 in August, bringing the total number of unemployed to 2.53 million, the highest total since 1998. President Zapatero will appear September 10 in parliament to discuss these and other poor economic indicators and the GOS response. Spain has one of the highest unemployment rates in the EU. The second quarter unemployment rate was 10.4 percent, and EU figures put the rate at 11% in July. The respected Savings Bank Foundation (Funcas) predicted that the rate would peak at 16% in 2010. Comment: Since undergoing a severe housing downturn beginning in 2007, Spain has experienced rapid increases in unemployment. The government's response is seen as lackluster at best by many Spaniards. (Ministry of Labor, All Media, 9/2; El Pais, 9/5)

Labor/Immigration Minister Proposes to Reduce Immigrant Labor

¶2. (U) Minister of Labor and Immigration Celestino Corbacho said September 3 that because of the high unemployment rate, the GOS would limit to almost zero the hiring in 2009 of foreign workers in their countries of origin, allowing only contracting related to specialized workers and to Spain's international commitments. Minister Corbacho's comments were heavily criticized by prominent labor unions and business associations, which noted among other things that immigration was not the underlying reason behind Spain's unemployment problem. In 2007, over 200,000 foreign workers were hired abroad, and 88,000 were hired between January and July of 2008. (El Pais, Expansion, La Vanguardia 9/4, 9/5)

ECB Collateral Tightening Not Expected to Affect Spanish Banks

13. (U) Although the international press has suggested that Spain could be affected by the European Central Bank's decision announced September 4 to tighten collateral requirements for its lending, Spanish press, bankers, and others with whom post has met seem confident that there will be little impact. A Bank of Spain (central bank) official noted that although Spanish banks had made increased use of the ECB window since the start of the financial crisis, what had happened was that German banks that had been going to the ECB to finance their purchases of Spanish mortgage-backed securities had stopped those purchases, so the Spanish banks had gone directly to the ECB and used the same type of securities as collateral. Even after the increase, Spanish banks are only making use of the ECB in proportion to the size of Spain's economy within the Euro zone, and they have available collateral that could support three times the amount of funding they need. (El Pais, 9/5; Bank of Spain meeting 9/3)

Corporate Profits Fall for First Time in Four Years

14. (U) The economic difficulties are being reflected in corporate earnings. The Spanish companies that are traded on Madrid's stock market reported first-half 2008 profits 0.02 percent below their profits for the first half of 2007. Without one-time items from two companies, the result would have been a 7 percent decline. A more telling sign of the impact of the slowdown came in second quarter profits, which were 6.4 percent below their second-quarter 2007 level, even taking into account the one-time items. This was the first quarterly decline in four years. Large companies that make up the Ibex 35 blue-chip index, many of which have profitable operations outside Spain, did much better than smaller companies; Ibex 35 companies' combined profits rose 17

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percent in the first half, while other companies' profits fell 98 percent. Analysts expect results to be worse in the coming quarters. (El Pais, 9/2)

Planned Cut in Solar Electricity Price Guarantee Sparks Criticism

15. (U) A European photovoltaic solar energy conference in Valencia this week (that a dozen USG officials attended) focused media attention on an impending decline in Spain's solar electricity incentives. In order to encourage investment and technological development, the GOS guarantees high prices to producers of different types of renewably-generated electricity. To limit costs to consumers (and itself, as it covers some of the costs), the GOS guarantees prices only to those projects that connect to the grid by a certain date. The existing guarantee of 45 cents of a euro per kWh for solar photovoltaic projects has sparked a boom in investment, but only projects that come on line before the end of September will receive it. The GOS plans to reduce to 29 or 33 cents the guaranteed price for future projects and to guarantee that price only for the first 300 MW that come on line per year. These prices are still far above the market price for electricity generated by coal or gas. Industry representatives have criticized the planned reduction, saying it will lead companies to halt investment plans. Environmental NGOs concerned about climate change and labor groups have also criticized the reduction. GOS officials are reported to be open to modest increases in the 300MW/year quota but not to changing prices. (El Pais, 9/2; El Confidencial, 9/4)

Iberdrola Receives Final Approval to Buy U.S. Utility Energy East

16. (U) New York state's Public Service Commission (PSC) approved Spanish energy giant Iberdrola's proposal to take over utility Energy East Corp. This acquisition and subsequent investments would represent one of the largest

investments in the United States by a Spanish company. The New York PSC's decision was the final hurdle for the multi-billion dollar deal, which has undergone scrutiny from regulators from several states for over a year. Iberdrola had said earlier in the summer that if allowed to purchase Energy East, it would invest \$2 billion in wind turbines in New York, doubling the amount of NY wind power capacity within a few years. The purchase would make it the U.S., second largest wind power provider and one of the ten largest U.S. electricity companies. Iberdrola representatives have indicated that they will study the conditions imposed by the state before deciding whether to proceed with the deal, but press reports suggest that the conditions do not appear to contain any dealbreakers for the company. (All Media, 9/4)

Telefonica Raises China Netcom Stake to 12 Percent in 800M Euro Deal

17. (U) Spanish telecoms giant Telefonica announced on September 4 that it would purchase over 800 million euros worth of shares of China Netcom, raising its stake in the company to a total of 12 percent. Telefonica is buying the shares from US-based fund manager Alliance Bernstein Holdings. When China Netcom merges with China Unicom, Telefonica will be the leading partner in the new company. Comment: Telefonica is diversifying from its traditional Latin America focus. Encouraging trade with and investment in China has been a focus of the Ministry of Foreign Affairs and other GOS players, and we expect additional significant actions from Spanish companies in the future. End Comment. (Cinco Dias, 9/5)
Aguirre